INDEX

		Page
Opinions Below		2
Jurisdiction		2
I.	Statement of the Case	2
II.	Statement of Issues	4
III.	The Entry of the Order for Liquidation was Proper	5
IV.	The Denial of the Petitioners' Application for a Stockholders Meeting is not Error	12
V.	The Decision of The Circuit Court of Appeals Raises No Question so Special or Important as to Require the Granting of Certiorari	13

TABLE OF CASES CITED

PAGE

Aldred Investment Trust et al. v. *Securities and Exchange Commission*, 151 F. (2d) 254 (CCA 1st 1945) 2, 3, 6

Aldred Investment Trust et al. v. *Securities and Exchange Commission*, 326 U. S. 795 (1946) 2

Bailey et al. v. *McLellan et al.*, 159 F (2d) 1014 (1947) 2, 3

Bailey et al. v. *Proctor et al.*, 160 F (2d) 78 (1947) 2

Cook v. *Cook*, 270 Mass. 534 (1930) page 542 5

Flemming v. *Heffner and Flemming*, 263 Mich. 561 (1933) .. 6

Graselli Chemical Co. Inc. v. *Aetna Explosives Co. Inc.*, 252 Fed. 456 (CCA 2d, 1918) 13

Securities and Exchange Commission v. *Aldred Investment Trust et al.*, 58 F. Supp. 724 (D. Mass. 1945) 2

Securities and Exchange Commission v. *Fiscal Fund, Inc.*, 48 F. Supp. 712 (D. Del. 1943) 7

Tower Hill-Connellsville Coke Co. of West Virginia v. *Piedmont Coal Co. et al.*, 64 F. (2d) 817 (CCA 4th 1933) Cert. den. 290 U.S. 675 ..... 6, 14

Tri-City Electric Service Co. v. *Jarvis*, 206 Ind. 5 (1933) ... 6

Supreme Court of the United States

OCTOBER TERM, 1946

No. 1275

In The Matter

of

FRANK BAILEY ET AL., INTERVENERS,
Petitioners.

vs.

EDWARD O. PROCTOR ET AL., RECEIVERS OF ALDRED INVESTMENT TRUST, SECURITIES AND EXCHANGE COMMISSION, WILLIAM J. MINSCH ET AL., INTERVENERS, ET AL.,
Respondents.

BRIEF OF WILLIAM J. MINSCH ET AL., IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

The respondents, William J. Minsch, G. L. Boveroux, Edwin F. Hannon and John D. Talmadge, as they are a protective committee for the holders of shareholders debentures of Aldred Investment Trust, interveners in this case, file this brief in opposition to the prayer of the petition for a writ of certiorari.

OPINIONS BELOW.*

Opinion of the District Court—The judgment and the unreported memorandum opinion accompanying it appear at page 131 of the Record.

Opinion of the Circuit Court—The opinion of the Circuit Court of Appeals affirming the judgment of the District Court appears at page 195 of the Record and is reported as *Bailey et al.* v. *Proctor et al.* at 160 F.(2d)78 (1947).

JURISDICTION.

The petitioners invoke the jurisdiction of this Court under Section 240 of the Judicial Code.

I.

STATEMENT OF THE CASE.

This case was brought by the Securities and Exchange Commission against the Aldred Investment Trust and its trustees and officers in order to enjoin the trustees and officers from acting as such because of gross misconduct and gross abuse of trust. The complaint also prayed for the appointment of receivers with the usual powers of receivers in equity to take over and hold all of the property of the trust subject to the order of the district court for liquidation and distribution to creditors and others entitled thereto (R. p. 10). After a trial on the merits the district judge found the trustees and officers (other than Ezra D.

*This case was formerly before this Court on the question of the appointment of receivers. Certiorari was denied. *Aldred Investment Trust et al.* v *Securities and Exchange Commission*, 326 U.S. 795 (1946). The opinion of the District Court and the opinion of the Circuit Court leading to the earlier petition for certiorari are reported as *Securities and Exchange Commission* v. *Aldred Investment Trust et al.*, 58 F. Supp. 724 (D. Mass. 1945) and *Aldred Investment Trust et al.* v. *Securities and Exchange Commission*, 151 F. (2d) 254 (CCA 1st 1945). See also *Bailey et al.* v. *McLellan et al.* 159 F. (2d) 1014 (1947) an appeal in this same case from an order fixing counsel fees in which certiorari is likewise being sought.

Hart) guilty of gross misconduct and gross abuse of trust within the meaning of Section 36 of the Investment Company Act of 1940, enjoined them from acting as trustees or officers and appointed receivers to reorganize or liquidate the trust (R. p. 26-28, p. 196)*. The district court found also that the trust was then insolvent (R. p. 33).

After the Circuit Court of Appeals had affirmed the district court judgment (*Aldred Investment Trust et al.* v. *Securities and Exchange Commission*, 151 F. (2d) 254 (CCA 1st, 1945) cert. den. 326 U. S. 795 (1945)), and while the petition for certiorari was pending in this Court the petitioners, Frank Bailey et al., acquired the controlling block of so-called "free stock" from one of the officers who had been found guilty of gross misconduct and gross abuse of trust. After certiorari was denied the petitioners filed in the district court a motion for leave to intervene (R. p. 50). They were first allowed to intervene only on the question of the sale of certain of the trust assets (R. p. 83) but on March 20, 1946, were allowed to intervene generally (R. p. 87). Other interventions were allowed from time to time (R. pp. 84, 108). These respondents, Minsch et al., were allowed to intervene (R. p. 112) as a committee for the protection of holders of shareholders debentures on April 26, 1946. On June 10, 1946, the case came on for hearing on four plans of reorganization which had been filed and on the question of liquidation of the trust. At the time of this hearing, the trustees and officers who had been found guilty of gross breach of trust and gross misconduct had resigned, and the trust had become solvent, the assets having a value substantially in excess of liabilities. On June 19, 1946, (R. p. 131) a judgment was entered by the district court disapproving all the plans of reorganization, denying the petitioners' motions and ordering the receivers to liquidate

*At the same time a complaint in a companion case brought by an individual debenture holder was dismissed on the ground that all the relief sought by him was granted in this case (R. p. 49) and the complainant in that case was allowed to intervene in this case. See *Bailey et al.* v. *McLellan et al.* 159 F. (2d) 1014, 1015 (1947).

the trust. From this judgment the petitioners appealed. The judgment was affirmed by the Circuit Court of Appeals for the First Circuit on the ground, among others, that a court of equity has inherent powers to liquidate an investment trust "where fraud, mismanagement or abuse of trust is present whether or not insolvency is likewise present" (R. p. 199). The petitioners, Bailey et al., now ask certiorari.

II.

STATEMENT OF ISSUES.

The issues involved in this case are:

1. Does a court of equity have power to order liquidation by the receivers of a so-called Massachusetts Trust which though insolvent when the receivership was commenced was solvent at the time the order for liquidation was entered and where the trustees and officers of the trust whose gross misconduct and gross abuse of trust led to the initiation of these proceedings had, prior to the entry of the order for liquidation resigned and disposed of their controlling stock interest?
2. If such power does exist, was there an abuse of discretion in exercising that power on the facts of this case?
3. Was the court's refusal to call a meeting of stockholders to elect new trustees wrongful?
4. Does the decision of the Circuit Court of Appeals raise any question so special or important as to require the granting of certiorari under Rule 38 of this Court?

III.

THE ENTRY OF THE ORDER FOR LIQUIDATION WAS PROPER.

A. *There was power in the court to enter such an order.*

Point 1 of the petitioner's brief accompanying the petition for a writ of certiorari relies upon the argument that the Investment Company Act of 1940 contains no specific authorization, and that courts of equity have no inherent power, to order liquidation of a corporation. The argument of the petitioners is that since the Investment Company Act of 1940 gives to the Securities and Exchange Commission no express authority to liquidate or ask for liquidation, a court is limited in a suit brought by the Commission to the remedies prescribed by the statute under which the suit is brought. It may be that the point of the petitioners argument is that the Securities and Exchange Commission cannot under the Investment Company Act force a liquidation. If this is so the point is meaningless as there are now parties complainant (including these respondents) other than the Securities and Exchange Commission who are entitled to relief in their own right.

The petitioners argue that a court of equity in the exercise of its inherent and general equity powers has no power to decree dissolution of a corporation. This contention has no application to this case. We are not dealing with a corporation but with a trust. It should be borne in mind that under our jurisprudence a corporation is a creation of the legislature. Therefore the courts have adopted a hands off policy when seeking to effect dissolution of a corporation by a method other than that contemplated by the legislature. The Supreme Judicial Court of Massachusetts said in the case of *Cook* v. *Cook,* 270 Mass. 534 (1930), page 542:—

> ". . . in the absence of legislative authority we have no jurisdiction on the suit of an individual to dissolve the corporation. '. . . the dissolution of a corporation is a peculiar function which resides primarily in the

> Legislature and is conferred upon courts only by explicit legislative authority.' *Olds* v. *City Trust, Safe Deposit & Surety Co. of Philadelphia,* 185 Mass. 500, 505. To decree the final dissolution of a corporation on petition by an individual 'is no part of the general jurisdiction of a court of law or of chancery, and can be justified only by express statute.' *Folger* v. *Columbian Ins. Co.* 99 Mass. 267, 276."

In the Aldred Investment Trust matter the court was not dealing with a corporation and the reluctance to order the liquidation or dissolution of corporations which has found expression in the Cook case and many of the opinions cited by the petitioners do not apply to the dissolution of a trust created by and owing its life not to the grace of the legislature but to the acts of the parties themselves. There has never been the reluctance to dissolve without legislative sanction other types of business organizations such as partnerships, trusts or joint venture that there has been in the corporate field.

However, even though Aldred Investment Trust were a corporation its dissolution by order of a court of equity would have been proper.

> *Tower Hill-Connellsville Coke Co. of West Virginia* v. *Piedmont Coal Co. et al.,* 64 F. (2d) 817 (CCA 4th 1933) cert. den. 290 U. S. 675
>
> *Tri-City Electric Service Co.* v. *Jarvis,* 206 Ind. 5 (1933)
>
> *Flemming* v. *Heffner and Flemming,* 263 Mich. 561 (1933)

The Circuit Court of Appeals for the First Circuit in its prior opinion, *Aldred Investment Trust et al.* v. *Securities and Exchange Commission,* 151 F. (2d) 254 (CCA 1st 1945), held that the original decree of the district court appointing receivers with either power to reorganize the capital structure or to liquidate the Trust was a proper order. This Court denied a petition for writ of certiorari (326 U. S. 795). It may properly be argued therefore that the prior decision

of the Circuit Court of Appeals established the law of the case, and that the present petition should not be considered by this Court upon that ground.

The Circuit Court of Appeals in its judgment, review of which is now sought, refused to rest its decision upon that narrow ground. It held "that a court of equity has inherent power to appoint a receiver to liquidate a corporation or investment trust where fraud, mismanagement or abuse of trust is present whether or not insolvency is likewise present." (R. p. 199) This conclusion we submit is correct, and as the Circuit Court of Appeals says, any arguments hinged upon statutory construction of the Investment Company Act of 1940 are eliminated.

The prior decision of the Circuit Court of Appeals has established the equitable jurisdiction of the district court over an insolvent investment trust. This general jurisdiction being affirmed the court's jurisdiction must continue to the extent that it may wind up the trust and distribute its property among the creditors and others entitled thereto, if such action is best calculated in the judgment of the court to protect the interests of all concerned. *Securities and Exchange Commission* v. *Fiscal Fund, Inc.*, 48 F. Supp. 712 (D. Del. 1943).

There remains the question whether or not the district court has lost that general equity power because of intervening solvency and the removal of the trustees and officers who were found guilty of fraud, mismanagement and abuse of trust and by the transfer of the controlling shares to the petitioners. As the Circuit Court of Appeals said in its opinion (R. p. 200):—

> "Since a receivership may be inaugurated for a solvent corporation, solvency, especially where it may be of a transient nature, does not terminate jurisdiction to continue a receivership created on grounds other than insolvency. Moreover, we believe that the jurisdiction existing at the time of creation of the receivership is a continuing jurisdiction and the questions of present solvency and removal from control of the offending

officers and trustees pertain not to jurisdiction but to the propriety of the exercise of such jurisdiction. Once having properly assumed jurisdiction of a corporation or trust by appointing receivers under its general equity power, a court should not terminate its supervision until or unless it becomes satisfied that equity has been done to those whose interests the court had originally been asked to protect."

B. *There was no abuse of discretion by the District Court in ordering liquidation.*

Assuming the existence in the district court of the power to order liquidation of this Trust there remains the question whether the order itself was an abuse of the discretion of the district court. There are present in the record in this case many facts any one of which would support the manner in which the discretion of the district court was exercised.

1. *There is no certainty that income would be earned by the trust sufficient to pay the interest on its outstanding debentures.*

There are outstanding $5,900,000 face amount of the 4½% debentures of the Trust. Since 1937 the value of the Trust assets has been substantially less than the face amount of the outstanding debentures. During the years 1940 to 1943 the earnings of the Trust were insufficient by a substantial margin to pay the interest on the debentures. Temporary solvency has been brought about by the sale of certain assets in the portfolio at a large profit and because of the post war stock market inflation. As is stated by the Circuit Court of Appeals (R. p. 201) there is doubt "as to the ability in the future of any portfolio to earn these interest requirements except by resort to speculative securities with the hope of capital appreciation". As the record indicates the so-called free stock owned by these petitioners represents only a small capital investment and controls the operations, policies and management of the large invest-

ment of the debenture holders. Quoting again from the opinion of the Circuit Court of Appeals (R. p. 201) "The inability to earn interest requirements induces the controlling shareholders to engage in capital appreciation investments or in speculative ventures to insure them a profit in one way or another, e.g., Hanlon's activities in the Eastern Racing Association stock."

The statement on page 20 of the petitioners' brief that there are surplus assets enough to pay ten years' interest requirements is no answer to this argument for liquidation. To each debenture issued by this Trust is attached a share of the Trust's common stock (R. p. 31). The payment of interest out of principal while perhaps not harmful to the debenture holders as debenture holders does deplete the amount to which they are entitled as stockholders.

2. *There is no certainty that the Trust will remain solvent.*

As stated by the petitioners on page 20 of their brief the Trust now has an asset value of approximately $8,600,000 almost all of which is in cash or government securities. This solvency of the Trust has been brought about, as previously stated, by the sale of certain speculative assets at a large profit and by the post war stock market inflation. Had the assets not been converted into cash or its equivalent the value of the portfolio would by now have declined substantially because of the decline in the stock market. It has been pointed out that under ordinary conditions the Trust would have difficulty in earning its interest requirements. Hence nothing would prevent the controlling shareholders from embarking in speculative investments to produce the required yield from the portfolio, thereby enhancing the risk of future insolvency of the Trust. As the Circuit Court of Appeals said (R. p. 202) the district court "properly felt that the debenture holders were entitled now to the cash salvaged from what had appeared to be a doomed enterprise."

The purpose of this comment is not to prove that the Trust was insolvent on October 9, 1946, or that it is insolvent as of the date of submission of this brief. It is intended to show that in the exercise of his discretion the District Judge was justified in a period of wide market fluctuations and unsettled market conditions in ordering liquidation of this trust.

It is apparent that the petitioners are desirous of reinvesting the assets of the Trust. If the order for liquidation is reversed and the assets turned over to the petitioners the debenture holders who had a prior claim to all the assets of the Trust at the time the petition was filed will be compelled once again to run the risk of a later insolvent position without their consent. So far as this record discloses there is not a single debenture holder (other than those debenture holders who are also holders of "free stock") who oppose the order for liquidation. Certainly there is not a single debenture holder (other than those who are also holders of "free stock") who appealed from the order of liquidation.

The Circuit Court of Appeals stated (R. p. 202, 203):—

> "No dissenting voice to the order of liquidation has arisen from the debenture holders who have the greater equity and whose interests the court was originally called upon to protect."

3. *This Trust does not meet the minimum standards required by the Investment Company Act of* 1940.

In the Investment Company Act of 1940, the Congress prescribed certain minimum safeguards which it felt necessary for the protection of the public which invests in trusts of this type. These protections include certain limitations on the capital structure found in Section 18 of the Act and also certain limitations as to voting power likewise in Section 18 designed to insure control of the trust by those persons whose money comprises the principal capital assets of the trust. This Trust does not meet these requirements. Of course, since the Trust was formed prior to the enact-

ment of the Investment Company Act of 1940, it may lawfully continue with the capital structure it now has and with the provisions providing for voting control as they now are. Nonetheless, a judge, in determining whether or not to order liquidation of a trust which was insolvent at the time the petition was filed may in the exercise of his general equity jurisdiction consider whether or not the trust meets the safeguards and the requirements which have been established by the Congress as minimum requirements for new business organizations. The Circuit Court of Appeals stated (R. p. 202):

> "Finally, it was indicated at the argument before us that one of appellants' primary motives for the continuation of Aldred was to preserve its security structure, inasmuch as a similar trust could not now be created under the Investment Company Act. The Act itself does not require the liquidation or reorganization of existing investment companies which do not conform to the new statutory standards. But when a court of equity has exercised its jurisdiction to appoint receivers of an investment company pursuant to a complaint charging gross abuse of trust on the part of the trustees or officers, we deem it proper for the court, in determining what would be the appropriate remedy in order to afford complete relief, to take account of the fact that the capital structure is not in conformity with the standards and safeguards which Congress has now written into law. That fact, in conjunction with the other facts in the case, may well render it fair and equitable to require the liquidation of the company in the absence of an acceptable plan of reorganization."

4. *No substantial injustice is done the petitioners by ordering liquidation of this Trust.*

A court may justifiably be reluctant to order liquidation of a going business if it means that a group of security holders who have contributed capital to the venture will be entirely frozen out by the liquidation. Such is not the case here. This is no longer a going business, its assets are

almost entirely cash. There is no existing business organization engaged in day to day operations which can be saved. If the Trust assets are restored to the Trust the trustees will in effect be starting a new business. In addition these petitioners have contributed no money whatever to the Trust, and the Trust has in no way benefited from their stock purchases from Hanlon. The Record discloses that these petitioners bought into this proceeding at a time subsequent to the decision in the district court and its affirmance by the Circuit Court of Appeals. These petitioners became stockholders at a time when the district court had in its memorandum accompanying the judgment of January 19, 1945 ordered liquidation of the Trust and when the Circuit Court in its opinion of September 17, 1945, when the case was before it on the first appeal had said:

> "In granting relief the District Court relied upon its equity power to appoint receivers with power either to reorganize or liquidate the trust." *Aldred Investment Trust et al.* v. *Securities and Exchange Commission*, 151 F. (2d) 254, 261 (1945).

These petitioners are in a different position from persons who have contributed capital to a going business venture. They bought into a receivership paying no money into the Trust and are not entitled to any straining of the equities in their favor. A liquidation of this Trust on the figures given by the petitioners on page 20 of their brief will yield to them a profit of over one million dollars on an original investment of something in the neighborhood of $150,000 (R. p. 107). A disposition of this case which reaches such a result can scarcely be said to be inequitable.

IV.

THE DENIAL OF THE PETITIONERS' APPLICATION FOR A STOCKHOLDERS MEETING IS NOT ERROR.

The one remaining point designated by the petitioner as one of the points upon which they rely is the refusal of the district judge to order a meeting of stockholders for the

purposes of electing new trustees. The reason assigned by the district judge for this refusal is found at Page 132 of the Record where he says that a meeting of stockholders to elect trustees is unnecessary since liquidation is about to commence. The futility of electing trustees under such circumstances is too obvious for further comment. The question hinges upon whether or not liquidation is proper. If liquidation is proper the election of trustees would be an entirely futile act. It is also perfectly apparent on examination of the record of this case that no meeting of stockholders is necessary in order to obtain an expression of the view of those stockholders as the petitioners own 110,000 shares of stock in the Trust out of a total of 171,500 shares outstanding, have intervened, and have expressed their views fully.

The right to hold such a meeting is not absolute and the district court may in the proper exercise of its discretion defer such meetings. *Graselli Chemical Co.* v. *Aetna Explosives Co. Inc.*, 252 Fed. 456 (CCA 2d, 1918).

V.

THE DECISION OF THE CIRCUIT COURT OF APPEALS RAISES NO QUESTION SO SPECIAL OR IMPORTANT AS TO REQUIRE THE GRANTING OF CERTIORARI.

The petition for a writ of certiorari is brought under Section 240 (a) of the Judicial Code which confers upon this Court the power to review on certiorari cases in the Circuit Courts of Appeal. Review by this Court is not an unqualified right but a matter of sound judicial discretion. Paragraph 5 (b) of Rule 38 of this Court sets forth the basis for the exercise of that discretion and states that certiorari will be granted only where there are special and important reasons for review.

No such question is presented requiring review by this Court. The petitioners have argued at length on the Investment Company Act of 1940 and urge that the case pre-

sents a novel question arising under that statute. This ignores the fact that the Circuit Court of Appeals expressly interpreted the judgment of the district court as having been rendered under general equity powers and affirmed the judgment on that basis saying:

> "By placing our decision upon the ground of general equity jurisdiction, we eliminate the argument hinged on statutory construction of the Investment Company Act of 1940. Nor do we think that it was intended that the district court be deprived of this aspect of its general equity jurisdiction by failing to refer specifically to it in that statute. Consequently, power did reside in the district court to appoint a receiver to reorganize or liquidate the Aldred Trust." (R. pp. 199-200).

There then remains the question of whether or not an order to liquidate a trust originally insolvent but solvent at the time of the order results in presenting a case in conflict with the decision of another circuit or otherwise raises an important question for review by this Court within the meaning of Rule 38 of this Court. Not only is the decision of which review is sought not in conflict with the decision of any other circuit court of appeals but is in agreement with the decision by the Circuit Court of Appeals for the Fourth Circuit in *Tower Hill-Connellsville Coke Co. of West Virginia* v. *Piedmont Coal Co. et al.*, 64 F. (2d) 817 (CCA 4th 1933) cert. den. 290 U. S. 675.

CONCLUSION.

The petition for a writ of certiorari should be denied.

Respectfully submitted,

ROBERT H. DAVISON
LEWIS L. WADSWORTH, JR.
15 State Street, Boston
Attorneys for Respondents, Minsch et al.

May 15, 1947